BEFORE THE
POSTAL RATE COMMISSION
WASHINGTON, D.C. 20268

RECEIVED
APR 1 3 38 PM '98

Postal Rate and Fee Changes, 1997) Docket No. R97-1

AMMA BRIEF

The Advertising Mail Marketing Association ("AMMA") submits this brief in accordance with the briefing schedule established by the Commission.

In general, AMMA supports the rates proposed by the Postal Service for both the Standard (A) Regular and ECR subclasses. AMMA's independent participation in this proceeding has had three primary purposes. We sought to discredit the proposal by Newspaper Association of America ("NAA") Witness Sharon L. Chown advocating a new "metric" to serve as the baseline for distributing institutional costs among the subclasses of mail. We also took issue with portions of two pieces of testimony from James A. Clifton, ABA/NAA-T-1 and ABA/EEI/NAPM-T-1. Finally, we offered two witnesses, Joseph E. Schick (AMMA-T-1) and Gary M. Andrew (AMMA-T-2) to support the proposition that the discounts for dropshipped Standard (A) commercial mail should be set at 100% of the cost savings recognized by the Postal Service as a result of the dropshipment worksharing. We address each of these areas in what follows.[1/]

[1/] The Newspaper Association of America has taken issue with the manner in which the Postal Service has developed the pound rates for Standard (A) ECR. The Mail Order Association of America ("MOAA") has shown in its brief that this criticism is invalid, and AMMA endorses the MOAA position.

The Chown "Metric" is Operationally Unacceptable and Indefensible as a Matter of Law and Economic Principle.

Ms. Chown's "metric" is advocated as an aid to the Commission in resolving the "problem" perceived by Ms. Chown to emerge from the following circumstances:

> Now consider a subclass of mail that only used delivery. Now we know we don't attribute very many delivery costs. When you get out on the street the bulk of those costs are considered institutional. That class would have very low attributable costs. Should that class as a result of avoiding all its mail processing costs, avoiding all the transportation costs, should it be allowed to avoid the institutional costs associated with delivery? Any my response is no. They should take that into account that a large portion of institutional costs are associated with delivery.

Tr. 25/13395 l. 19-96 l. 4. Ms. Chown offered this thumbnail synopsis of her solution:

> By weighting the attributable costs I give greater weight to the attributable costs of delivery, so if you are a subclass that only uses delivery, you are going to have a higher weighted attributable cost. Therefore, you will be assigned a greater proportion of institutional costs, all other things being equal. That's the problem I'm trying to correct here, is this by an unweighted cost giving greater -- what happens with nonweighted cost, if it gives greater weight to those functions that are already very attributed.

Tr. 25/13396 ll. 5-14.

There are several shortcomings to this analysis. Probably most important from the Commission's vantage is the fact that the arithmetic manipulation on which the Chown methodology rests cannot confidently be predicted to yield sensible results if applied consistently over time. The Chown metric does not reflect the requisite level of "stability" as Dr. Andrew defined that term:

> Any metric to be used in ratemaking must be designed to exhibit stability when the components of the metric undergo change. By stability, I mean that the metric should recognize when cost changes occur in a subclass of mail but not produce wide fluctuations in subclasses where no cost changes have occurred.

Tr. 36/19679 ll. 9-12. The hypothetical examples advanced by Dr. Andrew show the Chown metric results when one increases total costs by 25% through the incurrence of new system-wide institutional costs (assuming that nothing else changes). The current methodology will respond reasonably by increasing the rate of each of the three hypothetical classes by 25%, whereas the Chown metric will decrease the rates of one of the classes by 11% and increase the rate of another by 36%. Tr. 36/19683 (Table 2), 19684 (Table 3). This is obviously a cost change of a magnitude and variety not likely to reflected in real life, but, as Dr. Andrew testified, "when smaller changes were tested, the inconsistencies maintained the same relationships." Tr. 36/19683 n.15.

A comparably irrational outcome resulted when Dr. Andrew hypothesized a reduction in total costs of $25 through the implementation of worksharing activities by one class of mail. There, again, the current methodology resulted (still assuming everything else equal) in a defensible outcome while the Chown metric wobbled precariously, sending the rates of the worksharing class down by 23% and increasing the rate of a second class by 18%. Tr. 36/19685 (Table 4), 19686 (Table 5). When Dr. Andrew combined the two examples discussed above, the instability of the Chown metric was even more obvious and traitorous to the values of regulatory balance. In that circumstance, one of the classes had a four percent rate decrease and another a staggering 67% rate increase employing the Chown methodology. Tr. 36/19687 (Table 6), 19688 (Table 7).

An arithmetic manipulation that yields results of the kinds illustrated by Dr. Andrew is not a responsible aid to the Commission. Of course, the PRC could adjust markups in a way that would override the irrational volatility of the Chown "metric", but that would invalidate the utility of the entire exercise. It is more sound by far for the Commission to retain the existing and time-proven methodology.

That course is also more consistent with economic theory. As both Dr. Panzer (Tr. 34/18446, ll. 14-18) and Dr. Andrew (Tr. 36/19677 l. 13) testified, the weighted attributable costs advocated by Ms. Chown have no counterpart in conventional economic theory. Although Ms. Chown apparently believes her weighting process to create a proxy for incremental costs, it is the testimony of Drs. Panzer and Andrew that they do not. Ms. Chown offered no defense for her conclusion to the contrary.[2/]

Ms. Chown's approach is also unlawful. Ms. Chown consistently (and at a very literal level, correctly) contends that her methodology does not attribute costs. Nevertheless, if it is to have the effect contended for by Ms. Chown[3/] it will distribute more total Postal Service cost to some subclasses of mail by dint of the weighting function. The point is easily illustrated. Assume a category mail with attributable costs of $100 that the Commission, applying the statutory criteria, determines should additionally defray $54 of institutional costs, leaving this mail with a total cost burden of

---

[2/] It is also the case that even if Ms. Chown had managed to approximate the incremental costs of the "functions" that she defines, the fact would be irrelevant to the Commission in its ratemaking duties. See Tr. 36/19674-75 (Andrew).

[3/] "Therefore, you will be assigned a greater proportion of institutional costs . . . ." Tr. 25/13396 ll. 8-9. This is a part of the quotation set out more fully at page 2 above.

$154. Then apply a version of the Chown metric in which actual attributable costs are transformed into $200[4] of weighted average cost. If the same markup factor is applied, the total cost burden on this mail will be increased to $208.[5] There is nothing to the Chown metric that ought to change the way that the Commission applies the statute in order to determine the proportion of institutional costs that should be borne by any category of mail. And yet, the Chown markup results in a very significantly different distribution of institutional costs. The methodology must have either added or subtracted something from the statute. And this, of course, is impermissible.

Equally, the Chown methodology cannot be lawfully thought of as an attribution mechanism. Ms. Chown submits that there is a cost causative relationship between her functions and the institutional costs that she finds to be associated with or identifiable to those functions. Tr. 25/13398 ll. 20-24. Whatever the validity of that belief, Ms. Chown was very clear that she does not believe that subclasses of mail cause any institutional costs. AMMA/NAA-T1-5; Tr. 25/13323. Thus, the redistribution of costs accomplished by application of the Chown methodology cannot be thought an instance of permissible extended attribution. The Supreme Court reads the statute to link the attribution of costs with some demonstration of cost causation. <u>National Association of Greeting Card Publishers v. United States Postal Service</u>, 462 U.S. 821, 823 (1983).

4/ By Ms. Chown's recokoning, the weighting factor for her delivery function is 210.03%. Tr. 25/13288.

5/ ($200 x .54) + $100.

The Commission may not lawfully attribute costs on the strength of the Chown metric and the use of the metric to assign costs impermissibly twists the statutory factors that are meant to govern institutional cost assignment. We submit that any use of the Chown metric violates the law.

Dr. Clifton's Proposal That Standard (A) Regular Mail Pay The Price For His Proposed Decrease In The Rates For The Second And Third Ounce First-Class Mail Is Indefensible

Testifying for the American Bankers Association and Newspaper Association of America (ABA/NAA-T-1, Tr. 21/10815-89) James A. Clifton advocates a sharp decrease (from the USPS proposed 23 cents to Dr. Clifton's proposed 12 cents) in the rate for each of the second and third ounces for workshared First-Class mail. AMMA has no principled objection to that outcome. It is (or should be) exclusively a matter of concern for those who speak for the First-Class mail community. Dr. Clifton goes on, however, to disclose that:

> The second purpose of this testimony is to show that since the zero extra-ounce charge for the second and third ounces of Standard A mail is not cost-justified, the incremental extra-ounce cost of this [First-Class] mail is creating an apparent cross-subsidy to Standard A mail from other mail classes.

Tr. 21/10820 ll. 19-22. That recitation is followed by the recommendation, "that the relatively small test year revenue loss ($138 million) implied by my proposed change in the extra-ounce rates for workshared First Class mail be recovered by a small increase in the cost coverage of Standard A mail" (Id. ll. 23-25). We write briefly to stress that Dr. Clifton presented exactly no facts to support his highly empirical assertion of the existence of a cross subsidy. Dr. Andrew conclusively demonstrates that there is none.

Tr. 36/19207 (Tables 13 and 14), 19708 ll. 1-5. In light of this, Standard A mail may not be burdened by any alterations in First-Class rates recommended by Dr. Clifton.

After an inexplicable side step in rejoining to an AMMA interrogatory[6/] Dr. Clifton adopted the traditional regulatory analysis of equating the failure to cover incremental costs with the existence of a cross-subsidy:

> Q. Is one measure better than the other for determining the existence of a cross-subsidy? Do you have a view?
> A. In the definition that I believe you're referring to, which primarily exists in regulatory circles, less so in economic theory, but under that narrow definition then the incremental-cost test is the proper test of cross-subsidy.

Tr. 21/10984 ll. 1-7.

When questioned on the issue, Dr. Clifton conceded that he had no evidence of the existence of the cross-subsidy on which he based his funding proposal:

> Q. I was trying to ask a closely cabined and careful question, and let me -- let me try it in a slightly different way. Isn't it right that if there were a cross-subsidy of Standard A mail, that if the Postal Service discontinued providing Standard A mail delivery, the net revenues of the Postal Service would go up? Isn't that the incremental cost test?
> A. That is one definition of an incremental cost test, yes.
> Q. Well, is it a fair one?
> A. Yes, it's a fair one.
> Q. Do you have any evidence that if the Postal Service discontinued the delivery of Standard A mail its net revenues would increase?
> A. As mentioned, Mr. Wiggins, providing such was not within the scope of my testimony. I have therefore labeled --
> Q. I understand. Do you have any such evidence?
> A. I did not introduce any such evidence and, for that reason, I refer to it as an apparent cross-subsidy.

* * *

6/ When asked by AMMA to define the term "cross-subsidy," Dr. Clifton initially responded with reference to marginal costs. Tr. 21/10896.

> Q. But you don't have the rigorous evidence of the incremental cost test that would show you that the discontinuance by the Postal Service of the delivery of Standard A mail weighing three ounces would increase the Service's net revenues, do you?
> A. I don't have evidence, technical evidence, either way on that question.
> Q. So you don't have proof of cross-subsidy, is that correct?
> A. I don't have proof, I have a lot of indicative evidence though.

Tr. 21/10985 l. 16-86 l. 10, 10987 ll. 9-19.

That may be good enough for Dr. Clifton, but it certainly does not meet the standard to which the Commission is held in moving costs among subclasses.

On behalf of the Major Mailers Association, Mr. Bentley also urges decreases in the second ounce rate for First-Class mail, invoking some arguments that overlap some of the arguments made by Dr. Clifton. Prudently, Mr. Bentley does not make any claim that the First-Class rates are subsidizing any other subclass of mail. Indeed, Mr. Bentley gives the Commission absolutely no guidance as to where it should recover the revenue decrement that would result from adoption of his proposals. Mr. Bentley made this observation with regard to the funding of one of his recommendations:

> I note that it is unlikely that the Commission would make up the entire revenues attributable to a one-cent reduction in the First-Class stamp by increasing Commercial Standard Mail A rates, since that would produce a First-Class markup index of 112 and a Commercial Standard Mail A markup index of 124, a result that I would not recommend.

AMMA/MMA-T1-1, Tr. 21/11202. This is also a result that the Commission cannot adopt.

The ABA/EEI/NAPM Proposal That Standard (A) Mail Pay The Costs For Increased Discounts For First-Class Workshared Mail Should Be Rejected

Sponsored by the American Bankers Association, Edison Electric Institute and the National Association of Presort Mailers, James A. Clifton advances a rate proposal for first ounce workshared First-Class letter mail. ABA/EEI/NAPM-T-1, Tr. 24/12458-23634. He argues that the 7.1% roll forward factor for First-Class workshared mail implicitly proposed by the Postal Service is too large and proposes instead a -3.6% roll forward factor. The basis for this conclusion is terribly obscure in Dr. Clifton's testimony. The testimony submits, at Tr. 24/12496 (Table 14), certain "Corrected USPS Modeled Costs" citing to Technical Appendices B-1 and B-2. Table 14 is a crucial jumping off point for Dr. Clifton's ultimate rate recommendations presented at Tr. 24/12506 (Table 22).[7/] His actual rate proposal in Table 22 (Tr. 24/12506) is a judgmental reduction of the calculated numbers in Table 21. This is a fairly long way of saying that Table 14 is really the engine that drives Dr. Clifton's rate proposals.

When asked about appendices B-1 and B-2 on which the text says that Table 14 is based, Dr. Clifton had this to say:

> Q. And if you look at B-1 and B-2 you come out with significantly different bottom lines, if you would, there -- that ratio to reflect the roll-forward amount is that right?
> A. Yes. Those appendices are presentations of our earlier runs, different ways of looking at the dynamics through Test Year 1998 of mail processing unit costs. I think of the three that you are looking at now, we adopted by far the most conservative one.

Tr. 24/12708 l. 21-09 l. 4. Dr. Clifton subsequently testified that it was actually his answer to a Postal Service interrogatory that reflected the calculations surrounding his -3.6% roll-forward factor. Tr. 24/12703 l. 21-04 l. 2 referring to USPS/ABA&EEI&NAPM-T1-4, Tr. 24/12637-48.

7/ Table 14 in conjunction with Table 16 (Tr. 24/12498) leads one to the intermediate rate proposal contained in Table 21 of Dr. Clifton's presentation (Tr. 24/12505). See Tr. 24/12731 ll. 5-24.

When questioned about this document, which does reflect the -3.6% roll-forward factor, Dr. Clifton testified that the document did not produce the -3.6% factor, rather the -3.6% factor fueled the calculations that produced the document. Tr. 24/12704 l. 17-06 l. 25. The only justification for the -3.6 number is contained not in the voluminous text of Dr. Clifton's presentation, but in his answer to Postal Service Interrogatory 8 to him. Tr. 24/12653-55. That document deserves careful attention. What it essentially says is that the -3.6 figure was a function almost exclusively of Dr. Clifton's judgment. For all of the numbers that appear in all of the tables and appendices of his presentation, everything in his conclusions hinges on the validity of that number. It is interesting that in an earlier calculation, Dr. Clifton used a -2.8 factor. Tr. 24/12719 l. 20-20 l. 1. The larger negative number emerged after another change in model numbers required a larger negative to hold the same result.

It is plain enough that some judgment must be exercised in assessing costs as one rolls events forward to the test year. We submit that the judgment of the Postal Service deserves far more weight than Dr. Clifton's clutter of irrelevant numbers and unsure logic.

Even if one accepts Dr. Clifton's "corrected" Table 14 costs, another important analytic step is necessary to move between them and his recommended rates. That step is Dr. Clifton's rejection of the Postal Service's proposed benchmark and his reversion to the Commission's grudging endorsement of a single piece benchmark in MC95-1. That there were some errors made in the Postal Service's calculation of a bulk-metered mail benchmark is undeniable. But those errors have been corrected and the methodology endorsed by the Commission in MC95-1 is in place. There is no reason to revert to the benchmark methodology that the Commission was forced, for lack of an alternative, to employ in MC95-1.

Dr. Clifton testifies that there is no revenue loss associated with his proposed cost adjustments, because they reflect genuine economies. Tr. 24/12506. If Dr. Clifton is right in his cost changes, he is certainly right in this conclusion as well. He goes on to say, "there is a very small revenue loss of $117 million associated with my using the Commission's [MC95-1 benchmark] methodology." Id. at ll. 19-20. The Commission should reject Dr. Clifton's reversion to the prior benchmark methodology, and in doing so (whatever the outcome of its analysis of Dr. Clifton's roll forward analysis) eliminate any revenue effects.

If there is a revenue effect from consideration of Dr. Clifton's proposals, it is utterly inappropriate to "increase . . . the cost coverage of Standard A mail so that the test year revenue requirement is met." Id. at ll. 21-22. When proposing to shift revenue deficiencies from First-Class to Standard (A) mail in the context of his second and third ounce pricing proposal, Dr. Clifton at least offered a (we believe pretextual) basis for imposing cost burdens on Standard (A) mail. Here there is none and no burden is warranted.

The Dropshipment Discounts Should Be Set To Pass Through To Participating Mailers 100% Of The Cost Saved By The Postal Service

The Postal Service proposes to pass through less than 100% of the cost savings it realizes from drop entry of Standard (A) mail. Dr. Andrew calculates the discounts that would result from pass through to the mailer of 100% of the costs saved by the

Postal Service as a result of qualifying destination entry mail. He also shows how to keep his proposal revenue neutral for the Standard (A) Regular and ECR commercial subclasses. Tr. 21/10138 (Table 6). He endorses, from the prospective of an economist, the wisdom of the determination by the Commission in MC95-1 to adopt a 100% pass through in its recommended destination entry discounts, even though the Postal Service had proposed a 95% pass through for Standard (A) Regular mail in that case. Tr. 21/10132 ll. 2-21. Dr. Andrew also offers an illustration of why 100% pass throughs serve the interests of fairness and equity (Tr. 21/10135 ll. 6-11) and explains how the efficient operation of markets is best served by the 100% pass through. Id. 10135 l. 15-36 l. 6.

The Commission was right in its action on destination entry discounts in MC95-1; there is no reason for it to turn wrong here.

AMMA Witness Joseph E. Schick offers a different perspective on issues implicated by the discounts. One of the results of adopting the 100% pass through level advocated by Dr. Andrew is that the differential between the discounts for BMC and SCF entry returns closer to the .5 cent level of current rates. The 100% pass through yields a .4 cent difference between BMC and SCF entry, whereas discounts proposed by Mr. Moeller narrow that differential to .3 cents.

Mr. Schick demonstrates, from the vantage of one in the business of evaluating alternative uses of USPS services on a daily basis, that this change (or the avoidance of the more dramatic narrowing that would result from the adoption of the rates proposed by Mr. Moeller) could have telling consequences. In Mr. Schick's analysis, the harmful potential of the Postal Service proposal is not so much in the absolute rates resulting from a decrease in the pass through percentages, but the change in the differential between the BMC and SCF destination entry discounts. As Mr. Schick puts it "under the proposed rates, it is simply worth less -- by $2.00 per thousand -- to drop enter at a SCF than it is at current rates." Tr. 20/15238, ll. 2-3 (footnote omitted). Mr. Schick confirms his experience ". . . that the deeper mail is entered into the postal system, the greater the monetary and non-monetary benefits to both the mailer and the postal system." Tr. 20/15239, ll. 19-21. Obviously, a narrowing of the discount differential between SCF-entered and BMC-entered mail discourages in some measure deeper entry of mail and thus disserves the interest of both mailers and the Postal Service.

For these reasons, AMMA -- through the two witnesses whose testimony is discussed above -- advocates passing through 100% of the cost savings calculated by the Postal Service for dropshipped Standard (A) commercial mail.

Respectfully submitted,

Ian D. Volner
N. Frank Wiggins
Venable, Baetjer, Howard & Civiletti, LLP
1201 New York Avenue, N.W., Suite 1000
Washington, D.C. 20005
(202) 962-4800/FAX (202) 962-8300

Counsel to Advertising Mail Marketing Association

April 1, 1998

DC1:69853

CERTIFICATE OF SERVICE

I hereby certify that I have on this date served this document upon all participants of record in this proceeding in accordance with section 12 of the rules of practice.

N. Frank Wiggins

DATE: April 1, 1998

DC1:69853